Green energy’s $10tn revolution faces oil crash test

In 2014, when the price of oil last crashed, the world’s governments had no agreement in place to fight climate change. The following year leaders signed the Paris accord. Green investments have soared since then. Some $1.2tn has been poured into renewable energy, and global electric vehicle sales reached 2mn last year. Bloomberg NEF expects as much as $10tn poured into clean energy by 2050. The accord also marked a cultural watershed, with emissions targets now policed by a growing environment movement that’s shaping politics from Germany to India. In a sign of the times, activist Greta Thunberg and Tesla Inc founder Elon Musk are now two of the most famous people in the world. So when this week Saudi Arabia and Russia joined in a price war that wreaked havoc on global markets already rattled by the coronavirus, it looked like the major oil-producing nations reasserting their supremacy in the short term. Instead, it may prove to be another step in a longer-term trend towards ending oil’s power to hold the world to ransom. The price of a barrel of oil remains an important economic indicator. But the relentless push to move away from fossil fuels suggests that its

geopolitical impact is likely to be softer than in the past, with the imperative to combat global warming assuming its place. “The impact of the oil price on broader economic growth has been decoupling ever since the 1980s,” said Shane Tomlinson, deputy chief executive officer at environmental think tank E3G. “We could see exceptional movements in the oil price in the next few months, but I don’t think that changes the fundamental need to address climate change.” Oil’s fall to some $35 a barrel from $55 just last week has major implications for addressing climate change. Low prices incentivise more use of oil; it squeezes the budgets of oil companies, putting clean-energy projects in doubt; and some governments feel pressured to prop up struggling oil companies. All that drives up emissions, which is bad news for global warming. However, if low prices are sustained this time, there might be big positives for fighting climate change. Renewable energy is a more mature industry than five years ago. As it becomes a less risky investment, it has attracted big investors who are showering a lot of cash and building some projects that rival the capacity of conventional power plants. At the same time, oil exploration is becoming less viable economically, with an increased risk that even those projects that go ahead no longer yield good returns and with worries about stranded assets growing. “Now it doesn’t make sense to reduce your investment in renewables if the oil price crashes,” said Mark Lewis, head of sustainability at BNP Paribas Asset Management. “It’s more logical to reduce your investment in oil.” That reality points to a broader change in investor sentiment since Paris that aff ects companies and governments alike. A number of large investors have come together under groups such as Climate Action 100+ to demand companies put sustainability at the heart of their business models, and that isn’t likely to change. Tesla has eff ectively become a proxy for how the green economy is viewed by investors. Musk has demonstrated that a mass-market electric car is viable, prompting all the major carmakers to follow his lead. He’s building his latest plant outside Berlin, in a show

of his intention to take the fight to the heart of Europe's leading luxury car producer. Tesla is after all the world's second-most valuable carmaker by market value after Toyota Motor Corporation. For governments worldwide, pressure for policy measures has mounted as the issue increasingly resonates, in part due to the kind of direct action and media campaigning espoused by Greta Thunberg. Low oil prices off er one reason to heed that voter call, since it's a good time to end fossil-fuel subsidies or to raise taxes on consumption of fossil fuels. Such a move can also help avoid the sorts of destabilising anti-government protests seen in France, Iran and Ecuador when energy-price increases were proposed. It could even be done in a way that "protects or even benefits poorer households and communities," said Helen Mountford, vice president of climate and economics at the World Resources Institute. The goal of reaching out to "left-behind" communities is a dynamic driving policy from the post-Brexit UK to South Africa and swaths of Latin America that suff ered waves of unrest late last year. During the last down cycle, between 2014 and 2016, when oil briefly dipped below $30 per barrel, India cut annual fossil-fuel subsidies from $29bn to $8bn and even raised taxes on consumption. Some of the money raised was diverted to renewable-energy subsidies, after setting an ambitious goal to deploy as much as 175GW of mainly solar and wind power by 2022 — about twice the power generation capacity of the UK. "Many countries are pursuing electrification and decarbonisation to make them less dependent on the volatility of oil markets," said Adnan Amin, former director general of the International Renewable Energy Agency. "This kind of event will only reinforce that momentum." Also since 2014, the power of Opec's 14 nations to shape the market has been weakened by the impact of US shale production. (Opec's Vienna base is home to an Austrian government that now includes the Greens as junior coalition partner.) The US — which is not a member of the group — became an oil exporter again on the back of its shale revolution, surpassing Russia and Saudi Arabia in 2018 to regain its

status as the world’s biggest producer. President Donald Trump has cheered America’s energy resurgence as an example of taking back control. However, the collapse in oil prices weakens the shale industry’s ability to pump at a profit and even pushes some of the producers toward bankruptcies, adding to economic uncertainty surrounding the virus that may hurt Trump’s re-election bid, says Amin. Since Trump unilaterally pulled the US out of the Paris agreement, it could yet tilt the presidential race in favour of a candidate more in favour of climate action. In Brussels, meanwhile, European Commission President Ursula von der Leyen doubled down on European Union plans to achieve climate neutrality by 2050, despite the emergence of what she called “unforeseen challenges.” “Today it’s no longer the question if there will be a European Green Deal or whether the EU will become climate- neutral but the question is how we’re proceeding and how far-reaching will the transition be,” Von der Leyen said on Monday. That stance is understandable given that EU citizens say they want the bloc to focus on tackling climate change and preserving the environment as its No 1 priority, according to a recent Eurobarometer survey for the European Parliament. “Clearly we cannot ignore what’s going on globally,” said EU Environment Commissioner Virginijus Sinkevicius on Bloomberg TV. The global “climate emergency didn’t go anywhere.”

Clean energy is also resilient energy

NASSAU — The Caribbean and its surroundings are on the front lines of climate change. The Bahamas, the archipelago that stretches over the crystal-blue waters between Florida and Cuba, have been battered in recent years by devastating hurricanes, which have increased in severity and frequency as a result of global warming. As is the case worldwide, there is an element of injustice to this. Given that the Bahamas and Caribbean countries emit relatively minuscule amounts of carbon dioxide, their residents bear very little of the blame for the climate crisis.

But the people of the region are now flipping the script, transforming themselves from victims of climate tragedies into global leaders in clean, secure energy. The Caribbean countries have compelling economic reasons for embracing the green-energy transition. For generations, they have relied on imported fossil fuels to power their economies, which means they have long had to deal with the uncertainties of world oil markets and thus significant cost fluctuations for electricity.

Thanks to advances in renewable energies, that economic

challenge has created an opportunity. Unlike imported fossil fuels, which are subject to rising costs, the prices of solar power and other clean energy sources, along with the necessary battery storage systems, continue to fall. As these technologies have become more affordable and competitive with older, dirtier fuels, they have created a powerful incentive for island countries to move away from conventional fossil fuel-fired power plants. Moreover, this trend will only grow more pronounced from here on out, as the cost advantages of newer, cleaner energies make them increasingly attractive relative to fossil fuels.

For regions like the Caribbean, solar and battery storage systems do more than simply reduce the costs of electricity; when deployed in the right way, they also improve climate resilience. As the Bahamas and other countries across the region have demonstrated over the past few years, solar- and battery-powered microgrids can provide critical services for island communities during and after severe weather events that otherwise would knock traditional energy sources offline.

But in order for these new energy solutions to provide real resilience, they themselves need to be able to withstand the storms, which tend to ravage power lines and disconnect communities from centralised sources of energy generation. Thus, in the case of solar, much depends on the methods used to secure solar panels to the ground and to rooftops.

We already know that it is possible to construct photovoltaic (PV) systems capable of surviving even the most severe category of hurricane. Through a collaboration between the Rocky Mountain Institute, the government of the Bahamas and the country’s national utility, the Bahamas Power and Light Company, we have developed and installed a solar parking canopy at the National Stadium in Nassau that can withstand the winds of a category-five hurricane. We have also built the country’s first category-five resilient solar and battery storage microgrid on Ragged Island, and are now focusing on

designing and delivering sustainable and resilient microgrids for critical facilities on Abaco, following the destruction wrought by Hurricane Dorian in September 2019.

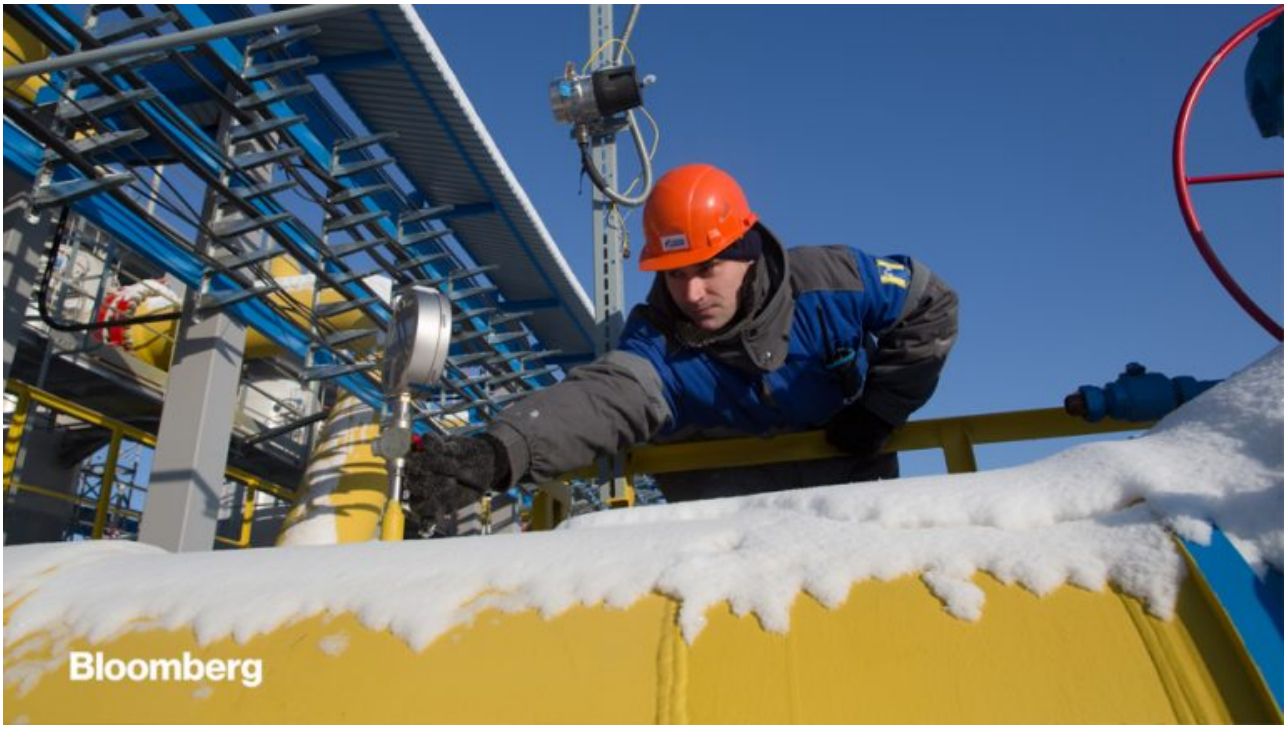
As the planet continues to warm, increased moisture in the air will translate into even more severe and frequent tropical storms and hurricanes. What we saw with Dorian and Hurricane Maria in Puerto Rico in 2017 is likely to become commonplace. Fortunately, as the partnership in the Bahamas shows, many of the same measures needed to build resilience are also those needed to limit greenhouse-gas (GHG) emissions and slow the pace of global warming. Far from requiring a tradeoff, resilient PV systems check both boxes.

The Caribbean and Atlantic are hardly the only regions that will need to build more resilient energy infrastructure to prevent power disruptions. Communities around the world are increasingly confronting the challenges posed by severe and extreme weather, including the devastating fires in Australia, Indonesia and the western United States.

In all of these cases, clean, localised energy solutions offer unique advantages in terms of reducing emissions and keeping the lights on after a disaster. They point the way to a better future for our electricity system. By embracing the clean-energy transition, the Bahamas is setting an example for the rest of the world – and particularly for those countries that are responsible for the overwhelming share of global GHG emissions.

Jules Kortenhorst is CEO of the Rocky Mountain Institute. Whitney Heastie is CEO of Bahamas Power and Light. ©Project Syndicate, 2020.

Why the OPEC-Russia Blowup Sparked All-Out Oil Price War



First Russia tossed a hand grenade into global oil markets. Then Saudi Arabia dropped a bomb. After the dramatic collapse of an alliance between the OPEC oil cartel and Russia, a one-day plunge of more than 30% in oil prices sent shockwaves through global financial markets already reeling from the fallout of the coronavirus epidemic. The blowup of Russia's deal with the 13-member club of oil exporters – an alliance that has underpinned world oil prices for three years – triggered a sudden price war.

1. What's the bustup?

Russia had joined forces with OPEC in 2016, along with nine other non-member countries, and the alliance controlled almost half of the world's oil production. The "OPEC+" pact led to a resurgence of the cartel, which wields immense power over the world's most critical commodity. Russia stunned oil traders when it refused to go along with production cuts pushed by Saudi Arabia at a March 6 meeting in Vienna. The kingdom –

OPEC’s biggest producer and its driving force — wanted to trim output further to prop up prices as the coronavirus ravaged energy demand. Saudi Arabia responded aggressively just hours later: Its state-owned oil behemoth said it would reverse course on March 8, open the taps and slash crude prices.

2. What led to the fallout?

Talks between Russia and the Organization of Petroleum Exporting Countries broke down because the country didn’t want to be strong-armed into further cuts to its lucrative oil production. It complained that the OPEC+ deal had aided America’s shale industry. Russia was also increasingly angry with the willingness of U.S. President Donald Trump to employ energy as a political and economic tool. It was irked by the use of U.S. sanctions to prevent the completion of a pipeline linking Siberia’s gas fields with Germany, known as Nord Stream 2.

3. What does this have to do with shale?

The Kremlin was reluctant to cede further market share to U.S. shale drillers — known as frackers — that have been adding millions of barrels of oil to the global markets. An attack on shale has been tried before: When the new technique was expanding in 2014, Saudi Arabia’s strategy was to flood the market, expecting that a collapse in prices would thwart the new competition. As shale producers found cheaper ways to operate and a global supply glut dragged on, OPEC then returned to its traditional tool of constraining output, sending oil to a four-year high of more than $85 a barrel by mid-2018. The victory proved self-defeating. Higher prices re-invigorated U.S. fracking, propelling the U.S. to overtake Saudi Arabia and Russia as the world’s No. 1 crude producer. Many drillers in Texas and other shale regions look vulnerable, as they’re overly indebted and already battered by rock-bottom natural gas prices.

4. Can Russia and Saudi Arabia live with lower prices?

That remains to be seen — the two sides could always return to the negotiating table. In the short run, Russia is in a good position to withstand a price slump. Its government budget breaks even at a price of $42 a barrel and it has squirreled away billions of dollars in a rainy-day fund. Saudi Arabia, which is almost entirely dependent on oil to fund lavish government spending, holds about $500 billion in foreign currency reserves to cushion the blow. One source of potential stress: The kingdom's currency, the riyal, has been pegged to the U.S. dollar for more than three decades, providing economic and financial stability. OPEC has a built-in competitive advantage, since its Middle Eastern members can produce crude at about a third of the cost of U.S. shale.

5. What about other countries?

Such a dramatic crash in the price of oil, if it were sustained, would savage national budgets of petro-states from Venezuela to Iran, threatening to upend politics around the world. To policy makers, volatile oil prices are an added complication as they try to shield economies from the impact of the coronavirus epidemic.

6. What's the wider fallout?

There are winners from rock-bottom oil prices — among them China, the world's largest oil importer, whose recovery from the virus will be key for the global economy. The U.S. — once a beneficiary of low oil prices — is now an exporter rather than a buyer. Sudden surges in oil prices are feared because of the way they could jack up costs across the global economy and slow economic growth. Now a world reeling from an economic slump triggered by the virus is enduring another sort of oil shock.

Shale’s New Reality: Almost All Wells Drilled Now Lose Money

America’s shale producers already had a profitability problem. It just got a lot worse.

At a stroke, Saudi Arabia and Russia and their battle for market share have made almost all U.S. shale drilling unprofitable. Only five companies in two areas of the country have breakeven costs lower than the current oil price, according to data compiled by Rystad Energy, an Oslo-based consultancy.

Wells drilled by Exxon Mobil Corp., Occidental Petroleum Corp. Chevron Corp. and Crownquest Operating LLC in the Permian Basin, which stretches across West Texas and southeastern New

Mexico, can turn profits at $31 a barrel, Rystad's data show. Occidental's wells in the DJ Basin of Colorado are also in the money at that price, which is where oil settled Monday.

But that's not the case for the rest of the shale industry — more than 100 operators in a dozen fields. For them, drilling new wells will almost certainly mean going into the red.

Shale projects are heralded for their ability to be quickly ramped up and down. But because output from these wells declines much faster than from their old-school, conventional cousins, companies have to drill more of them just to keep output flat. That has meant sluggish investor returns, one of the main reasons oil and gas represents less than 4% of the S&P 500 Index.

At this point, "companies should not be burning capital to be keeping the production base at an unsustainable level," said Tom Loughrey, a former hedge fund manager who started his own shale-data firm, Friezo Loughrey Oil Well Partners LLC. "This is swing production — and that means you're going to have to swing down."

Already, producers including Diamondback Energy Inc. and Parsley Energy Inc. have said they're cutting their drilling budgets and dropping rigs. Others, such as Apache Corp. and Occidental, have indicated they'll rein in activity.

"What they're not saying is that they're going to suspend activity," Loughrey said.

In his view, a typical well in the Midland sub-basin of the Permian requires $68 oil for investors to make an adequate return within 24 months.

BloombergNEF expects producers to move away from using breakeven costs that leave out overhead and other necessary expenses as investors shift their focus to cash flow.

“At a minimum, they will need to add back interest costs to their calculus,” BloombergNEF said in a report. That means the profitability floor for most new wells will rise to $50 a barrel “in the not too distant future,” according to the report, up from $45 in the past.

The shale boom turned the U.S. into the biggest oil producer in the world and, in recent months, a net exporter of petroleum. But if prices remain near $30 a barrel, producers will be forced to ax so much drilling activity that U.S. oil production could fall by 2 million barrels a day from the end of this year to the end of next, according to Rystad.

That would be about a 20% drop.

On Monday, West Texas Intermediate crude fell 25% to settle at $31.13 a barrel, and some forecasters see it falling toward $20. Prices clawed back some of those losses Tuesday, reaching as high as $33.73.

“Even the best operators will have to reduce activity,” said Artem Abramov, head of shale research at Rystad. “It’s not only about commerciality of the wells. It’s a lot about corporate cash flow balances. It’s almost impossible to be fully cash flow neutral this year with this price decline.”

IEA: Oil Demand To Drop For First Time Since 2009

Global oil demand is set to drop this year for the first time since the financial crisis in 2009, the International Energy Agency (IEA) said on Monday, as it slashed its demand outlook by 1.1 million bpd due to the coronavirus outbreak and its impact on economies.

The IEA now sees global demand falling by 90,000 bpd year on year in 2020, the agency said in its Monthly Oil Market for March 2020, after its executive director Fatih Birol warned two weeks ago that the coronavirus outbreak could hit global oil demand growth more than initially expected.

In the February market report, the IEA had slashed its 2020 oil demand growth forecast by 365,000 bpd to just 825,000 bpd—the lowest oil demand growth since 2011, and warned that the coronavirus outbreak would lead to the first quarterly contraction in global oil demand in more than 10 years.

In view of the global spread of the coronavirus and its impact on the global economy, the agency now expects full-year oil demand to drop.

“While the situation remains fluid, we expect global oil demand to fall in 2020 – the first full-year decline in more than a decade – because of the deep contraction in China, which accounted for more than 80% of global oil demand growth in 2019, and major disruptions to travel and trade,” the IEA said in its March report.

The report commented on the collapse of the OPEC+ coalition, saying that the implication is that “the OPEC+ countries will be free to exercise their commercial judgement when assessing future levels of production.”

The IEA report comes a day after Saudi Arabia effectively launched an oil price war on Russia after the former allies abruptly ended the OPEC+ agreement last Friday. Over the weekend, the Saudis slashed their official selling prices by $6-7 a barrel to all markets including Asia, and signaled they would boost production as of April, sending oil prices into a tailspin on Monday to the biggest fall since 1991.

How oil’s plunge might end up boosting US natural gas prices

A sharp reduction in shale oil drilling because of crude’s crash could end up boosting US natural gas prices and potentially curb an oversupply in the global market for liquefied natural gas.
Oil markets have crashed by almost a third to less than $35 a barrel after the disintegration Friday of the Opec+ alliance, which has triggered a price war between Saudi Arabia and Russia. If the plunging price discourages shale oil drilling,

the knock-on effect could be a cut in the supply of gas extracted as a byproduct, according to Goldman Sachs Group Inc.

If shale producers invest on the basis of $30-$45 per barrel of crude over the next 5 quarters, there will be about 1bn cubic feet a day less US gas production, said Goldman analysts including Brian Singer. That's about 1% of US daily natural gas output in December.

"US producers tend to respond to prices with a lag of a couple of months, though we see the response time narrowing, given flexibility of shale and greater focus on free cash flow," the Goldman analysts said.

Front-month US gas futures fell as much as 9.8 cents, or 5.7%, to $1.610 per million British thermal units, the lowest intraday level since August 27, 1998. Prices losing just 1/10th of a cent from there would put it at the lowest since September 1995.

The US is brimming with gas as production booms. This has been particularly acute in the Permian formation, where prices for gas extracted from oil drilling have tumbled below zero, meaning producers will pay others to take the fuel off their hands. Output from the West Texas and New Mexico shale play is rising faster than pipelines can be built to carry it away.

In Europe, which has boosted imports of US LNG, front-month benchmark Dutch prices were down 3.2% Monday after earlier falling as much as 5.8%.

If European gas prices "were to drop any further, we should see a downward adjustment in LNG exports from the US to Europe as exporters of spot cargoes would not be covering their operational costs," said Carlos Torres Diaz, head of gas and power markets at Rystad Energy AS.

The plunge in oil may turn the global gas industry on its head. Gas supply contracts linked to oil prices, which have been out of favour as gas dropped faster than oil, will probably become attractive again. "You could certainly see gas prices in the US supported by low oil prices," said Ciaran Roe, global director of LNG at S&P Global Platts, in an

interview. Last year’s view where oil linkages were frowned upon “looks to be receding into the rear-view mirror.”

Oil prices plunge, hit by erupting Saudi-Russia oil price war

NEW YORK – Oil prices crashed on Monday, suffering their biggest daily rout since the 1991 Gulf War, after the collapse of an OPEC+ supply agreement that now threatens to overwhelm the world with oil, inciting panic throughout the energy sector.

After failing to come to an agreement to cut supply, Saudi Arabia and Russia over the weekend pledged instead to ramp up

production, which could quickly flood global markets with oil at a time when demand has already weakened substantially.

The market’s reaction has been furious, with crude futures plunging by nearly 20%, while energy stocks collapse as shale producers frantically cut future expenditures in anticipation of a drastically different outlook than a few days ago.

Brent crude futures were down $8.84, or 19.5%, to $36.43 a barrel by 10:49 a.m. EDT (1449 GMT). They earlier fell by as much as 31% to $31.02, their lowest since Feb. 12, 2016.

U.S. West Texas Intermediate (WTI) crude fell $7.81, or 18.9%, to $33.47 a barrel. WTI earlier dropped 33% to $27.34, also the lowest since Feb. 12, 2016.

Should these losses hold, it would be the biggest one-day percentage decline for both benchmarks since Jan. 17, 1991, the outset of the U.S. Gulf War, when it fell by a third.

A three-year supply pact between members of the Organization of the Petroleum Exporting Countries, which includes the group’s top producer Saudi Arabia, and Russia fell apart on Friday after Moscow refused to support deeper oil cuts to cope with the outbreak of coronavirus.

OPEC responded by removing all limits on its own production, prompting fear of a supply hike in a market already awash with crude.

Despite sliding demand for crude due to the coronavirus, Saudi Arabia plans to boost its crude output above 10 million barrels per day (bpd) in April after the current deal to curb production expires at the end of March, two sources told Reuters on Sunday. Saudi Arabia also cut its official crude selling price.

The kingdom has been producing around 9.7 million bpd in recent months.

Russia, one of the world's top producers alongside Saudi Arabia and the United States, also said it could lift output and that it could cope with low oil prices for six to 10 years.

The countries along with several other producers have cooperated for three years to restrain supply. The OPEC+ talks collapsed after OPEC effectively presented Russia with an ultimatum on Thursday, offering it a choice of accepting a deal with much bigger than expected cuts or no deal at all.

"The prognosis for the oil market is even more dire than in November 2014, when such a price war last started, as it comes to a head with the significant collapse in oil demand due to the coronavirus," Goldman Sachs said.

Saudi Arabia, Russia and other major producers last battled for market share in 2014 in a bid to put a squeeze on production from the United States, which has not joined any output limiting pacts and which is now the world's biggest producer of crude.

The global outbreak of the coronavirus prompted OPEC to seek additional output cuts. More than 110,000 people have been infected in 105 countries and territories and 3,800 have died, the vast majority in mainland China, according to a Reuters tally.

China's efforts to curtail the coronavirus outbreak has disrupted the world's second-largest economy and curtailed shipments to the biggest oil importer.

The International Energy Agency said on Monday oil demand was set to contract in 2020 for the first time since 2009. It cut its annual forecast by almost 1 million bpd and that the market would now contract by 90,000 bpd.

Major banks also have cut their demand growth forecasts. Morgan Stanley predicted China would have zero demand growth

in 2020, while Goldman Sachs sees a contraction of 150,000 bpd in global demand.

Bank of America reduced its Brent crude price forecast from $54 a barrel to $45 a barrel in 2020.

“The radical shift in policy suggests that Saudi will allow inventories to build sharply over the next three quarters,” said a Bank of America Global Research report. “As a result, we now expect Brent oil prices to temporarily dip into the $20s range over the coming weeks.”

(Additional reporting by Dmitry Zhdannikov in London, Aaron Sheldrick in Tokyo, Scott DiSavino in New York and Shu Zhang in Singapore; Editing by Marguerita Choy and Edmund Blair)

Column: Even before price plunge, hedge funds were abandoning oil

LONDON (Reuters) – Even before the OPEC+ output agreement broke down on Friday, sending oil prices into a tailspin, hedge funds had launched a second wave of oil-related selling and established one of the most bearish positions since the price crisis of 2014-2016.

Hedge funds and other money managers sold the equivalent of 133 million barrels in the six most important petroleum futures and options contracts in the week ending on Tuesday.

Funds were sellers of Brent (60 million barrels), NYMEX and ICE WTI (31 million), U.S. gasoline (25 million), U.S. diesel (4 million) and European gasoil (12 million).

Over the last eight weeks, portfolio managers have sold a total of 579 million barrels, more than reversing purchases of 533 million in the final quarter of 2019.

The hedge fund community's overall long position had been slashed to just 392 million barrels by March 3, down by 60% from 970 million at the start of the year, and the lowest since the start of 2019.

Fund managers have a in-built bullish long bias: they have never held a net short bearish position at any point in the last seven years, according to an analysis of data from regulators and exchanges.

But the data can be adjusted to remove “structural” elements from long and short positions (the minimum number of long and short positions which never change) to show the underling “dynamic” position more clearly.

On March 3, portfolio managers had a dynamic position that was net short by 99 million barrels, the most bearish since the start of 2019 (tmsnrt.rs/38xhDyp).

Overall, funds now hold just two bullish long positions for every bearish short, down from a ratio of almost 7:1 at the start of the year, and among the most bearish ratios at any point in the last seven years.

Portfolio managers have become especially negative about the outlook for distillate fuel oils such as diesel and gasoil, the refined products most closely connected with the business cycle.

Unusually mild winter weather throughout the northern hemisphere has cut heating oil consumption; now the coronavirus epidemic threatens an extended slowdown in global manufacturing and trade.

As a result, funds’ long-short ratio in middle distillates has fallen to just 0.7:1, compared with 2.4:1 in crude and 5.3:1 in gasoline.

Funds are more bearish on distillates than at any time since the global economy was still struggling to emerge from the commodity slump and mid-cycle manufacturing slowdown of 2015/16.

These bearish positions in crude and fuels had all been

established before Saudi Arabia and Russia failed to agree on extending and/or deepening their output cuts at the OPEC+ meeting on Friday.

The combination of unrestrained production and weakening consumption has sent Brent prices down by a further $16 per barrel (31%) since Tuesday as investor sentiment has soured on the economy and oil even further.

Since Friday, Brent prices have experienced their sharpest one-day fall since U.S. forces moved to end Iraq's occupation of Kuwait in January 1991, as traders respond to the unexpected collapse of the OPEC+ supply accord.

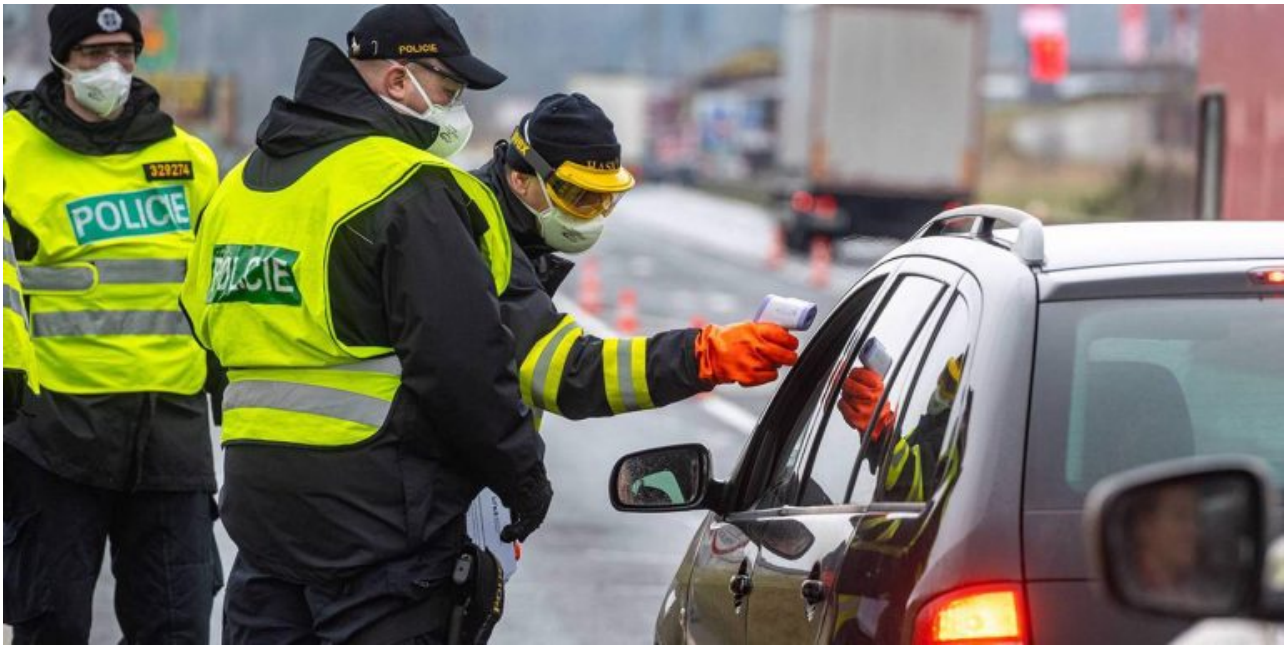
With Russia and Saudi Arabia now likely to lift output cuts and produce at their maximum capacity, prices will adjust down to the level set by the marginal producer, which in the last five years has been U.S. shale.

Related columns:

– Hedge funds paused oil sales, before coronavirus prompted second wave of selling (Reuters, March 2)

– Oil traders price in coronavirus-driven recession (Reuters, Feb. 28)

How Europe Should Manage the Coronavirus-Induced Crisis



either interest-rate cuts nor new government spending would do much to offset the short-term effects of COVID-19 in Europe. Central banks and government authorities should explain this to the public, and then focus their attention on the less glamorous work of safeguarding public health, household incomes, and the financial system.

BRUSSELS – The spread of the COVID-19 coronavirus across Europe and the United States has led to a sharp financial-market correction and prompted calls for active monetary and fiscal policy to prevent a recession. But a closer look suggests that such an approach might not help much at all.

The COVID-19 epidemic is marked by uncertainty. Technically, it does not represent a "black swan" event, because there have been other pandemics before. But it was, until a few months ago, unforeseeable, at least in specific terms. And it will have a long-lasting impact even if its precise evolution cannot be predicted today.

For now, it seems that the virus is moving westward. In China, where the virus emerged, infections are declining after the authorities implemented radical measures – including lockdowns that brought the economy to a standstill for over two weeks. Although it is too early to tell whether the virus has really

been contained, economic life now seems to be normalizing gradually, implying that the “China shock” may be unwinding.

In the US and Europe, by contrast, the shock seems to be just beginning, with a fast-growing number of new infections raising the specter of severe economic disruption. This risk is particularly pronounced in the eurozone, which may not be able to weather a severe downturn without spiraling into crisis.

To be sure, the epidemic’s direct fiscal consequences seem manageable. Even Italy, which is currently suffering the most, could increase public spending for virus-containment measures without violating EU fiscal rules.

If these costs spiral – as seems likely, now that a quarter of the country, accounting for most industrial and financial activity, is under lockdown – the European Union should be able to offer support to Italy beyond allowing the government to run a larger deficit. Article 122.2 of the Treaty on the Functioning of the EU allows the European Council to grant financial assistance to a member state facing “severe difficulties” caused by “exceptional occurrences beyond its control.” This procedure should be activated now.

In any case, COVID-19’s trajectory suggests that it will likely spread farther, forcing other EU member states to adopt public-health measures at the expense of economic activity, particularly in important sectors such as travel and tourism. Moreover, supply chains will be impaired, not only by the temporary shutdown of the Chinese export machine, but also by disruptions within Europe. Neither interest-rate cuts nor new government expenditures would do much to offset the short-term effects of such shocks.

The more serious problems are likely to emerge from the financial system. While many firms can slash production quickly, running a business in “disaster recovery mode” still

costs money, and debt still comes due. In Europe, where labor costs cannot be cut in the short run, the challenges this raises could be particularly serious.

Fortunately, most EU members have some system in place under which the government covers the wages of workers who become temporarily redundant for reasons outside of their employers' control. These mechanisms, which would sustain personal incomes during the crisis, are the main reason why a long-lasting drop in consumption is unlikely. Once the virus is contained, European consumers will have little reason not to spend as much as before.

Yet two other possible developments could tip the eurozone into recession. The first is a sharp slowdown of global trade, which the EU has little power to counter. The second is a collapse in investment, which the EU can and should work to prevent.

The last eurozone crisis demonstrated that investment collapses when the financial system stops functioning. In market-based systems, like that of the US, this is a question of risk premia and plain access to credit, which policymakers can hardly influence. For Europe, with its bank-centric financial system, the key to weathering the COVID-19 crisis is thus to keep the banking sector healthy.

For that, a calibrated supervisory response is essential. The shift of banking supervision to the European Central Bank has led to more rigorous and selective credit policies by commercial banks. While this has reduced banking risks, applying tough lending standards at a time of severe economic stress caused by public-health measures could punish otherwise creditworthy firms that are facing temporary losses.

Italy's government is providing direct financial support to companies directly affected by the lockdowns. But if the crisis spreads, the number of sectors that are affected (often

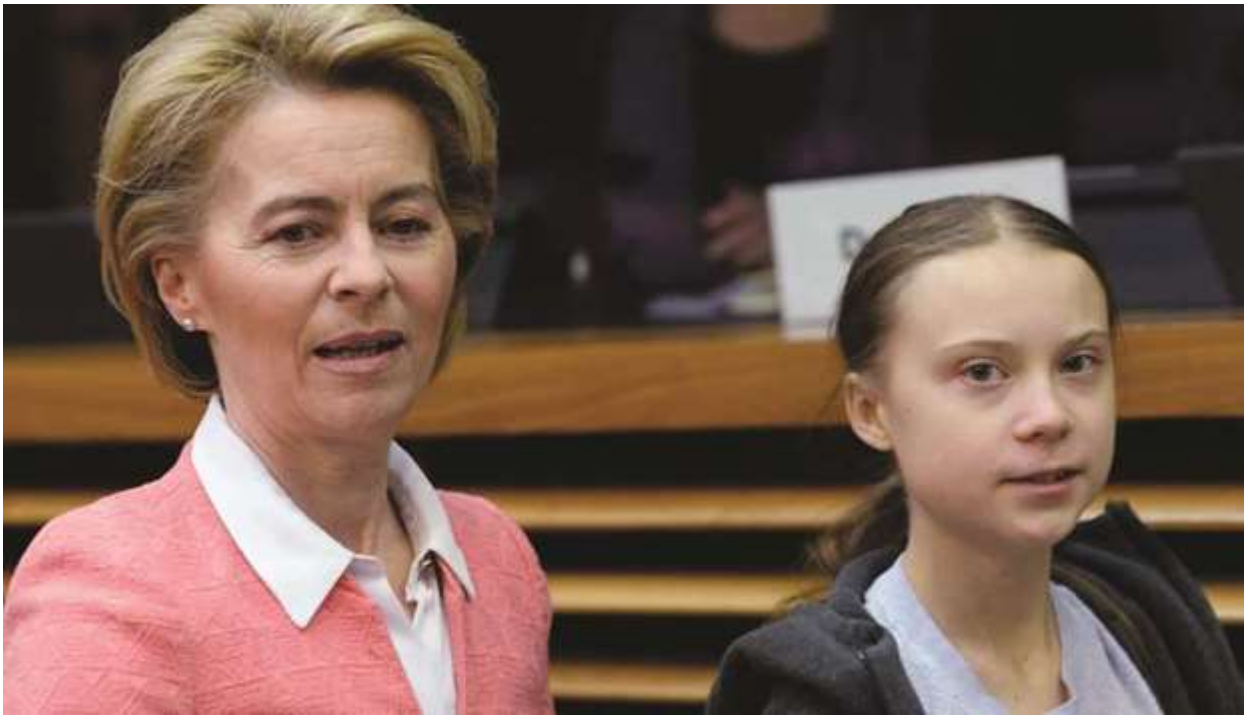
indirectly) will increase. Governments cannot provide financial support to all of them. Banks can do much more, but only if they are willing to overlook bad financials. Supervisors should allow – and even encourage – such an approach.

A forbearance-based approach – together with the "automatic" fiscal stabilizers built into Europe's social-security systems – would do far more to mitigate the risk of crisis than microscopic interest-rate cuts.

Additional fiscal stimulus, meanwhile, would be needed only in the unlikely event that the economic disruption is followed by a period of depressed demand. The eurozone's fiscal rules pose no obstacle to such a policy mix, because they are flexible enough to permit temporary deficits that result from lower tax revenues, or fiscal support to sectors hit hard by exceptional circumstances. Nonetheless, the COVID-19 epidemic should serve as a reminder of the value of maintaining prudent fiscal policy during normal times. Countries with lower deficits and debts are in a much stronger position to respond to the COVID-19 shock than those, like Italy and France, that have not created fiscal space.

In the face of a severe shock, public authorities must act – and be seen acting. But, in this case, the usual macroeconomic instruments are unlikely to work. Central banks and government authorities should explain this to the public, and then focus their attention on the less glamorous work of safeguarding public health, household incomes, and the financial system.

Europe embarks on economic revolution with climate law



Bloomberg/Brussels

Europe wants to make it illegal by 2050 to emit more greenhouse gases than can be removed from the atmosphere.

European Commission President Ursula von der Leyen unveiled a draft law yesterday that would commit the region to become the first climate-neutral continent by the middle of the century. The legal proposal is the cornerstone of the bloc's Green Deal, a far-reaching strategy that foresees a radical overhaul of the European economy over the next three decades.

"The Climate Law is the legal translation of our political commitment, and sets us irreversibly on the path to a more sustainable future," von der Leyen said in a statement. "It offers predictability and transparency for European industry and investors. And it gives direction to our green growth strategy and guarantees that the transition will be gradual and fair."

The draft measure proposes a binding target of net zero greenhouse gas emissions by 2050, with a revised target for

2030 to be put forward only later this year. That triggered criticism of the law by environmental activists, including Greta Thunberg, who called the law “surrender” because it doesn’t ensure more rapid action.

The commission has already started a deep analysis of the existing 2030 goal to cut emissions by at least 40% and aims to finish it by September, according to European Commission Vice President Frans Timmermans. Von der Leyen pledged to increase it to 50% or even 55%.

“Once we’ve done this work, we’ll propose an amendment to the climate law that we’re presenting today and we’ll put the 2030 target there as well,” Timmermans told a press conference in Brussels yesterday. The clash over the path to get to net-zero emissions highlights the challenges policy makers face as they seek to balance business interests with the ambitions of an ever-growing green movement. Fighting climate change has catapulted to the top of the EU’s agenda, with 93% of Europeans seeing global warming as a serious problem.

The Green Deal was designed to appease these concerns and become a new growth strategy for the 27-nation bloc. But regulatory proposals by the EU’s executive arm are subject to approval by member states, and the climate law reflects the need to seek a compromise between competing national positions. With differing energy mixes, wealth and industrial strength, EU governments are set to wrangle over every bit of the climate strategy and the draft law that will set the basis for the clean-up.

However, the dynamics may change with the draft measure. It will pave the way for a new regulatory track where measures to cut emissions avoid a veto by a single country, a tool that was used several times by coal-dependent Poland to halt ambitious policies.

Once approved by national governments and the European Parliament, the climate law will start a regulatory frenzy. Everything from energy production to agriculture and the design of cities will be overhauled under the Green Deal strategy that von der Leyen has described as a moonshot. “I’m

excited by this," said Peter Vis, senior adviser at Rud Pedersen Public Affairs in Brussels. "Von der Leyen is setting the ambition without knowing how we will get there. But when Kennedy committed to putting a man on the moon he also wouldn't know if that is possible."

Here are the main elements of the draft law:

* EU-wide emissions and removals of greenhouse gases must be balanced by 2050 at the latest
* Member states must take necessary steps to enable collective achievement of the goal by the EU
* Commission will review the current 2030 emission-reduction goal by September, exploring options for a new goal of 50%-55%
* By June 2021, commission will assess how to amend various rules on emissions, including a law on the bloc's carbon market
* By September 2023, the commission will every five years assess the progress made by member states following global stock-takes under the Paris Agreement to protect the climate
* Commission may propose new climate targets every five years following the assessments; trajectory to get to climate neutrality will start with the goal for 2030

The EU executive is also seeking more powers to make sure the bloc delivers on the net-zero emissions goal, making it more difficult for governments and the EU Parliament to object to intermediate targets. It wants to regulate those goals via measures known as delegated acts. To oppose them, a qualified majority of votes is needed in the Council of the EU, which represents member states, and a majority in the Parliament.

The biggest challenge for Europe will be to secure investment for the environmental clean-up. The costs are dizzying: to reach the existing 2030 goal Europe needs investment of €260bn ($290bn) annually.

Earlier this year, the commission proposed a 1tn-euro plan designed to be the financing pillar of the Green Deal. It envisions earmarking around €500bn from the EU budget for the clean shift over the next decade, while separately leveraging €280bn of private and public investment and establishing a

funding mechanism with another €143bn, also from public and private sources, to help regions facing the most costly clean-ups.

To ensure the Green Deal materialises to be Europe’s new growth strategy, new markets must be developed, with both public and private finance flowing to small and large companies alike to help them deploy first new technologies, according to Marco Mensink, director general of the chemical industry association Cefic.

“The proposal for a climate law is an important first step to achieve investor confidence, which is crucial,” Mensink said. “It is a start of an important journey; our sector must go through a deep transformation, within only one or two investment cycles, for which we need enabling conditions. Therefore, much more is needed.”